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GMR Infrastructure

Rs59
OUTPERFORMER

Infrastructure

Delhi international airport visit note

Mkt Cap: Rs229bn; US$4.9bn

We visited the Indira Gandhi International Airport (IGIA) project and met the management of GMR as the greenfield Terminal 3 (T3) gets ready for commissioning by end-July 2010. The T3, developed by Delhi International Airport (DIAL, 50.1% stake with GMR), would be one of the largest airports in Asia with a capacity to handle 34m passengers. Built at a cost of Rs127bn, IGIA would function as an integrated terminal, handling all international airlines and all full service domestic airlines (along with their low cost associates). Completed in 37 months from commencement of construction (ahead of some of the best global benchmarks), the visit reinforced our favorable view of GMR's execution capabilities, one the most critical aspects of infrastructure projects. While the airport is ready to commence operations (see pictures in Annexure), regulatory uncertainty on tariff (aero charges) determination persists, which we view as a key operating risk going forward. The commissioning of T3 and a sharp rise in associated interest and depreciation costs are expected to lead to reported losses at the PAT level over the next 2-3 years, till such time as revenues catch up with growth in passenger traffic and real estate development. However, we do not expect any cash losses going forward. We have valued DIAL at Rs79bn, including cash flows from award of real estate development rights, implying a value of Rs39.6bn for GMR's share in the project. We like GMR for its strong project management and execution capabilities, amply demonstrated in the smooth commissioning of complex projects over the last few years. Commencement of cash flow generation from the commissioning of two key projects – IGIA and the 235MW gas-fired barge-mounted merchant power plant are expected to the key triggers for the stock in the near term. We maintain Outperformer on GMR.

❑ Delhi international airport – commercial operations to commence from end-July 2010

The modernization of the Indira Gandhi International Airport (IGIA) at Delhi, awarded to Delhi International Airport (DIAL, 50.1% owned by GMR) on BOT basis in May 2006, is almost complete with commercial operations at the greenfield Terminal 3 (T3) expected to commence over the next few days. When completed, IGIA would have a capacity to handle 34m passengers annually and would be one of the largest airports in Asia, and one of the only airports of its size to have been completed in a record time of 37 months. The project also included refurbishment of the existing domestic and international terminals, and construction of a new domestic terminal (1D) as well as a new runway, which were completed earlier.

❑ T3 to function as an integrated terminal; LCCs to continue from 1D

T3 has been developed as an integrated terminal for domestic as well as international airlines. International airlines are expected to shift from the existing Terminal 2 from 28 July 2010 and domestic airlines (with their low cost associates, if any) would shift from Terminal 1D on 27 August 2010. Pure low cost carriers, however, would continue to function from Terminal 1D. Thus, from end-August 2010, IGIA would function with just two operating terminals, 1D and T3.

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❑ Finishing touches remain; but unlikely to hamper commencement of operations

With construction complete, the airport is currently undergoing trial runs with participation from all stakeholders including DIAL, airlines, ATC, security, etc. We observed minor construction activities underway in certain areas and finishing touches being given to certain other sections in the terminal building. However, these activities were mainly around duty free, retail and F&B areas and, hence, are likely to be completed well in time for commencement of operations. In any case, we do not expect these activities to impact airline operations and passenger movement. Hence, we see no constraint in T3 commencing operations on the scheduled dates.

❑ Visit reinforces comfort on GMR's execution capabilities

We believe execution is a key competitive advantage in infrastructure projects, where time and cost overruns can significantly impact project IRRs. After the completion of the Hyderabad and Sabiha Gokcen international airports well within their scheduled timelines, the quick implementation of IGIA reinforces our belief in GMR's capability to execute large and complex projects. The greenfield T3 would be one of the few airports of its size globally to have been completed in a span of just 37 months from the date of commencement of construction and about 50 months from the date of award of project.

Exhibit 1: IGIA compares very favourably with other international airports on completion schedule

Airport	Passenger capacity (m)	Completion (months)
Changi T3, Singapore	22	76
Heathrow T5, London	25	60
Beijing, China	45	60
IGIA, Delhi	34	37

Source: Company

❑ Project completed at a cost of Rs127bn

The IGIA modernization project has been completed by DIAL at an approximate cost of Rs127bn, as against Rs89bn envisaged earlier. The escalation in the project cost has been led mainly by construction of Terminal 1D (not part of the concession agreement) and an increase in cost of materials (EPC contract awarded on cost plus basis). The additional cost is proposed to be funded through proceeds of award of real estate development rights, security deposits collected from non-aero concessionaires and collection of additional airport development fees (the approval for which is awaited).

❑ Regulatory uncertainty on aero charges continues

DIAL will need to get the project cost approved by the Airports Economic Regulatory Authority (AERA), for the purpose of determination of tariffs to be charged from airlines and passengers. The methodology of tariff determination itself remains ambiguous at present, with differences in the methodology proposed by the regulator and the procedure for the same contained in the concession agreement signed with the government.

❑ JV model adopted for non-aero ervices

For operating non-aero activities at IGIA, DIAL has adopted a model different from the generally accepted model of granting a separate sub-concession for each activity. At IGIA, while separate sub-concessions have been awarded for each non-aero service, DIAL would hold a stake in the JV holding the concession. Thus, the duty free concession would be handled by a JV of DIAL and Aer Rianta, with day-to-day operations to be handled by Aer Rianta. The JVs would pay DIAL through a mix of upfront fees/ deposits and a share of revenues. DIAL has collected upfront deposits of ~Rs5bn from the award of non-aero concessions at IGIA. The total aggregate capex in these JVs is expected to be Rs21bn, and DIAL's likely equity contribution is estimated at Rs2.25bn.

Exhibit 2: A separate sub-concession for each non-aero activity at IGIA but DIAL to hold a stake in the JVs

Non-aero activity	JV partner	DIAL's stake (%)
Duty Free	Aer Rianta	49.9
Cargo	Celibi	26.0
Cargo	Cargo Service Centre	26.0
Advertising	Times Innovative	49.9
Fuel Farm	IOCL / BPCL	26.0
Food & Beverages	Devyani International	40.0
Food & Beverages	SSP Catering	40.0
Food & Beverages	Travel Food Services	40.0

Source: Company

❑ High fixed costs to lead to reported losses during FY11-13; but no cash losses likely

A project cost of Rs127bn is likely to lead to a sharp jump in fixed interest and depreciation charges at DIAL once the project is commissioned. However, revenues are likely to pick up gradually as passenger traffic increases and operations stabilize. As a result, while revenues and EBITDA are expected to see a sharp jump over the next 2-3 years led by commissioning of the new terminal and re-pricing of non-aero concessions, we expect DIAL to report losses on the PAT level due to high interest and depreciation costs. We, however, expect the airport to continue making cash profits.

❑ DIAL valued at Rs79bn; GMR's share at Rs39.6bn

Using the DCF methodology, with a 30-year concession term and an equity discount rate of 16%, we have valued DIAL at Rs79bn. Our value includes the integrated value of potential future real estate development of ~26m sq. ft, excluding ~6m sq. ft already awarded. Thus, we value GMR's 50.1% stake in DIAL at Rs39.6bn, or Rs10/ share of GMR.

❑ Maintain outperformer on GMR

We like GMR for its strong project management and execution capabilities – amply demonstrated in the smooth commissioning of complex projects over the last few years. Given the sharp jump in fixed interest and depreciation charges, near-term earnings may witness pressure despite strong revenue growth. However, as operations scale up, we expect strong traction in earnings as operating leverage kicks in. Commissioning of two key projects – IGIA and the 235MW gas-fired barge-mounted merchant power plant, and commencement of cash flow generation are expected to be key triggers for the stock in the near term. We maintain our Outperformer rating on GMR.

❑ Annexure

Exhibit 3: Testing baggage handling systems with mock bags

Exhibit 4: Duty free area – finishing touches pending

Exhibit 5: Arrival baggage carousels

Exhibit 6: Domestic arrivals

Exhibit 7: Moving walkways to ferry passengers to gates

Exhibit 8: The Canyon – floor to roof height lobby between check-in and immigration areas

Exhibit 9: Immigration counters for departing passengers

Exhibit 10: Immigration area for arriving passengers

Exhibit 11: Retail area (lower level) and F&B area (upper level)

Exhibit 12: DIAL – key statistics

Capacity/ Infrastructure statistics	Details	Units	Comments
Total airport area	5,100	acres	
Total floor area of the terminal building	5.5	m sq. ft	
Total passenger capacity	60	m	To increase to 100m in future
- of which T3	34	m	
- T1	26	m	T2 with 9m pax capacity will be shut down
Total retail area	20,000	Sq. mtrs	
Runways	3	nos	Length of the new runaway is 4.4km
Total check-in counters	168	nos	
Immigration counters	95	nos	49 outbound and 46 inbound
Total aero bridges	78	nos	90% of passengers at T3 would be using the aero bridges
- for domestic	36	nos	
- for international	42	nos	
Baggage belts	12	nos	Provision for 2 more
Baggage handling capacity	12,800	bags/ hour	
Multi-level parking slots	4,300	nos	
Surface parking slots	2,300	nos	
Operating/ Financial statistics			
Concession start date	April-06		
Concession period	30+30	years	
Revenues in FY10	11.3	Rs bn	
Recurring PAT in FY10	172	Rs m	
Revenue share (%)	46		
1) Passenger traffic (FY10)	26.1	m	
2) Cargo handled	0.5	m tonnes	
3) Air Traffic Movements (ATMs)	229.2	in '000 nos	
Current ADF			
- per departing domestic passenger	200	Rs/ pax	
- per departing international passenger	1,300	Rs/ pax	

Source: Company

Exhibit 12: GMR SOTP

Asset		Valuation				
(Rs m)	Description	Method	Eq. rate (%)	Stake (%)	Eq. value	GMR value
Power						
Operational						
Mangalore (Tanir Bavi)	220MW - Naphtha	DCF	15	100	7,106	7,106
Chennai	200MW - Liquid fuel	DCF	14	51	6,383	3,255
Vemagiri	389MW - Gas	DCF	14	100	7,933	7,933
InterGen	6,254MW total	DCF	15	50	12,976	12,976
Under construction						
Kamalanga	1,050MW - Coal	DCF	18	80	11,089	8,871
Alaknanda	300MW - Hydel	DCF	18	100	7,949	7,949
Emco	600MW domestic coal	DCF	18	100	2,304	2,304
Vemagiri Extension	768MW Gas	DCF	17	100	6,148	6,148
Chhattisgarh	1,200MW - Coal	DCF	18	100	7,783	7,783
Under development						
Bajoli Holi	180MW Hydel	DCF	20	100	839	839
Talong	160MW Hydel	DCF	20	88	1,000	880
Upper Karnali	300MW Hydel	DCF	20	51	4,296	2,169
Upper Marsyangdi	250MW Hydel	DCF	20	95	7,967	7,569
Indonesian coal mines	100mn ton reserves	1.5x P/BV	NA	100	5,640	5,640
Homeland Energy	S.A coal mine holdco	1.5x P/BV	NA	33.5	2,362	2,362
					91,773	**83,783**
Airports (including real estate)						
Delhi			16	50	79,072	39,615
Hyderabad			15- 17	63	97,938	61,701
Sabiha Gokcen			18	40	5,190	2,076
					182,200	**103,392**
Roads						
Tuni (GTAE)	Annuity road	DCF	9	100	1,091	1,091
Tambavaram (GTTE)	Annuity road	DCF	9	100	1,660	1,660
Pochanpalli (GPEL)	Annuity road	DCF	12	100	583	583
Ambala-Chandigarh (GACEL)	Toll road	DCF	14	100	(1,534)	(1,534)
Jadcherla (GJEL)	Toll road	DCF	14	100	1,513	1,513
Ulunderpet (GUEL)	Toll road	DCF	14	100	2,232	2,232
Chennai ORR	Annuity road	DCF	14	100	30	30
Hyderabad-Vijaywada	Toll road	DCF	16	100	274	274
					5,849	**5,849**
Others						
Krishnagiri SEZ			18	98	12,385	12,137
Net holdco cash / Investments			NA	100	30,554	30,554
					42,939	42,691
Total					**322,761**	**235,715**
Shares O/S (m)						**3,892**
Value (Rs / share)						**61**

Source: IDFC Securities research

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